

Risks and opportunities for the financial sector in an aging society

Speech by Ryozyo Himino, Vice Minister for International Affairs, Financial Services Agency, Japan, at the G20 Symposium: For a Better Future: Demographic Changes and Macroeconomic Challenges, January 17, 2019, Tokyo



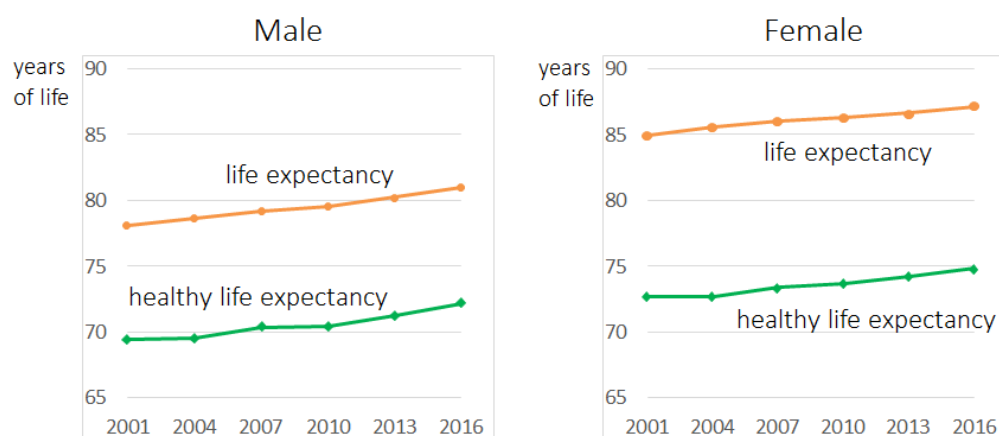
When Paul McCartney sang *When I'm Sixty-Four* in 1967, it was taken for granted that, by the age of 64, one would be retired and spending their days quietly, perhaps "mending a fuse" or "doing the garden." Today, however, Paul is 76 and still jumping and shouting on stage. Last year his latest album topped the Billboard 200.

Being 64 in Japan

Let's first look at what it means to be 64 in Japan today.

- Life expectancy is getting longer and longer; half of those born in 2007 are expected to live beyond 100. And it is not just life expectancy that is getting longer. So is "healthy life expectancy," which is defined as the period during which people can continue to enjoy their daily activities without health limitations. At 64, one expects to live both longer and healthier.

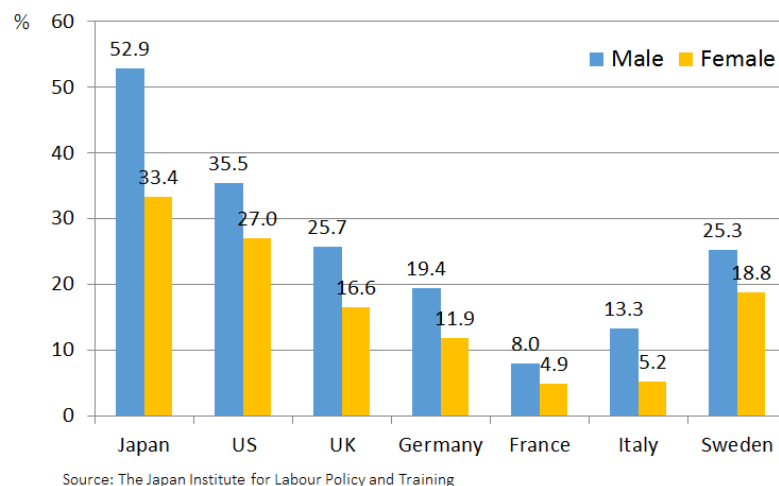
Life expectancy and healthy life expectancy



Source: Ministry of Health, Labour and Welfare

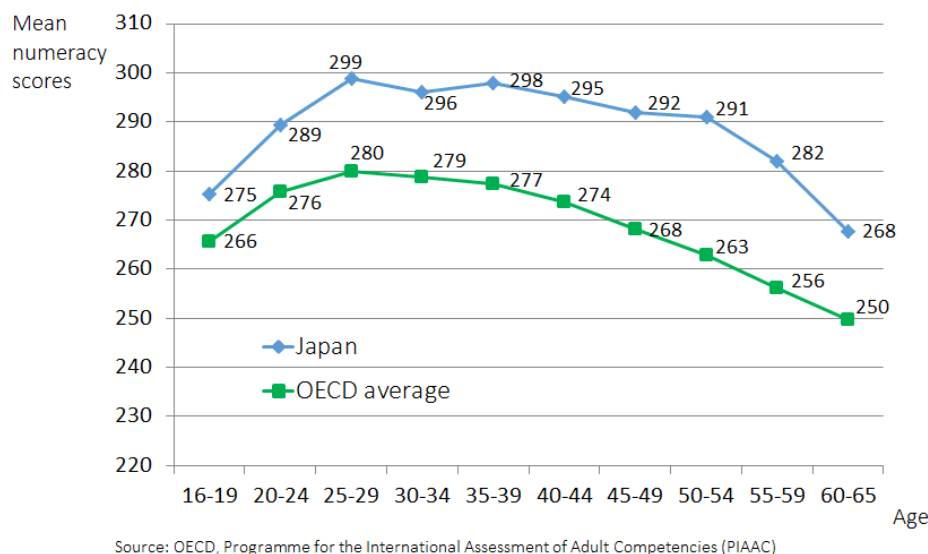
- In Japan, 64 is not necessarily the time for retirement. In fact, 53% of men and 33% of women between the ages of 65 and 69 are still working. These ratios are by far the highest in the world.
- Nowadays, three-quarters of people between the ages of 60 and 69 use the internet. Older people may now spend more time online than “doing the garden.”

Employment rate of people aged 65-69 in 2016



- Cognitive decline is a major source of concern, but, according to an OECD survey, mathematical thinking and reading skill test scores for Japanese people between the ages of 60 and 65 are equivalent to the OECD average for people between 45 and 49.

Levels of numerical proficiency



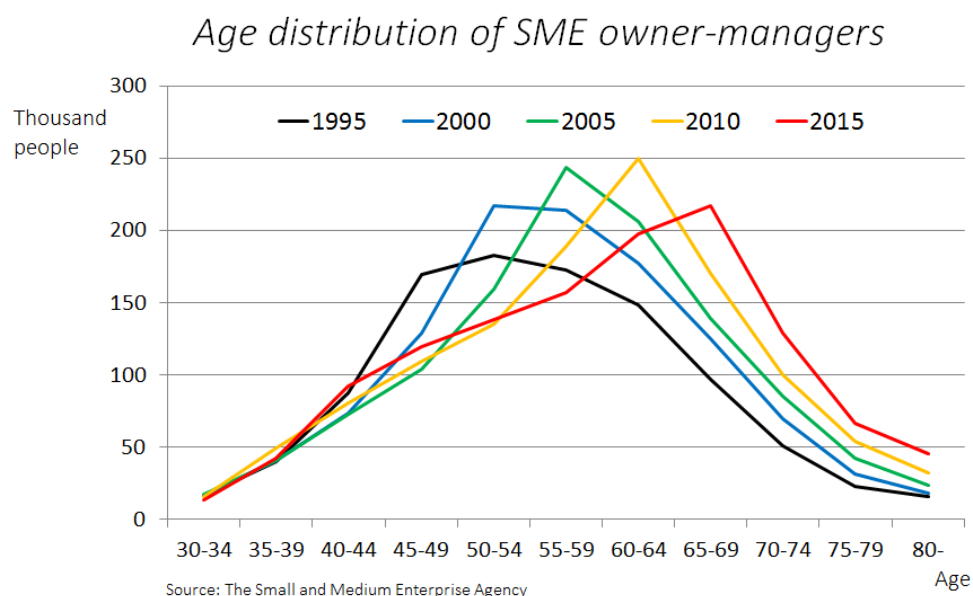
As these slides show, an aging society is not just a society where the ratio of older people increases. Older people themselves change and evolve. What I want to argue today is that while aging may pose risks to the financial sector, the financial sector has the potential to fulfil new roles that help seniors meet the challenges ahead – thereby turning risks into opportunities.

In Japan, shrinking regional communities and the flat and low yield curve are making it difficult for financial institutions to add value and earn profits through conventional business lines. Revenues are declining while costs and risks grow. In the past, regulators could focus on excessive risk taking, but today they also need to pay attention to sources of stress which are chronic and build gradually.

But risks can be turned into opportunities if the financial sector can be transformed to provide solutions to the challenges of an aging society.

SME succession

Let me take several examples. The owner-managers of Japanese SMEs are getting older. It is expected that more than two million of them will retire over the next ten years, yet half have not found their successors. We've already seen the number of SMEs going out of business increase. For banks, this could mean reduced business opportunities and increased credit risks.



Banks are already stepping up their efforts to meet these challenges. They are enhancing support to SME customers, providing advice on succession, M&A consulting, training to succession candidates, and networking opportunities.

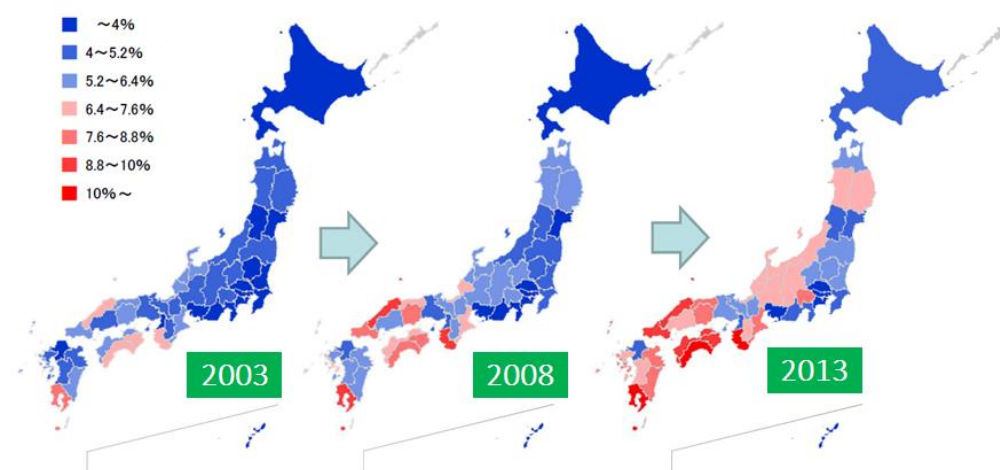
Perhaps, however, more could be done. Banks' existing business practices may make succession difficult. Many Japanese banks reduce the burden of monitoring credit risk by requiring owner-managers to personally guarantee SME loans. Even if an SME owner finds a successor, she or he may not be willing to make such guarantees.

However, with the advent of the Internet of Things (IOT), the digitization of transactions and payments, and improvements in artificial intelligence, the cost of monitoring and predicting SME cash flows may fall. By relying more on monitoring rather than on personal guarantees, banks can help solve succession problems.

Vacant houses

Another emerging risk from aging is the growth of unoccupied houses and shops. The number of vacant houses, even excluding houses for rent or sale, increased from 1.2 million in 1983 to 3.2 million in 2013. In some areas, more than ten percent of houses are sitting empty for extended periods. Growing vacancies will reduce the collateral value of homes as well as the demand for residential mortgages, posing risks to banks.

Ratio of vacant housing to housing stock



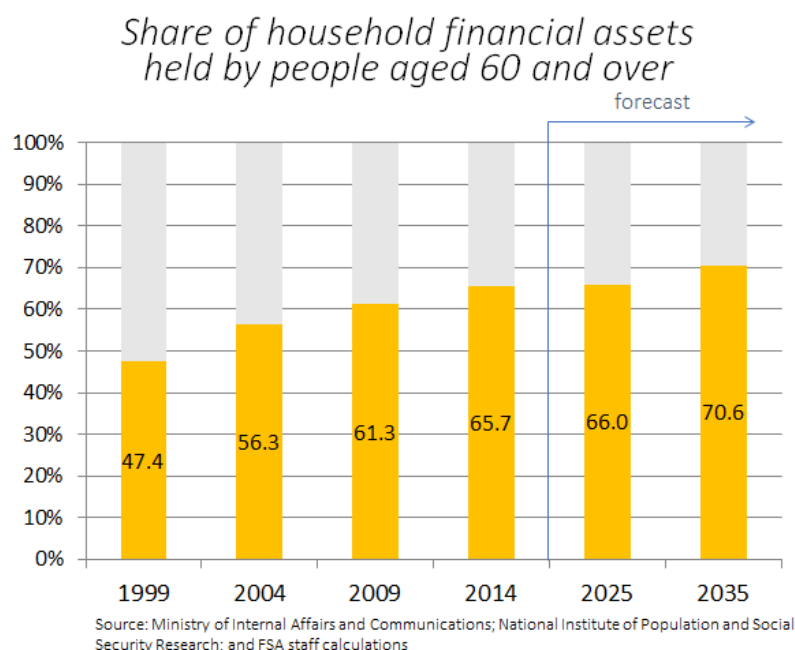
Source: Ministry of Land, Infrastructure, Transport and Tourism

Vacancy is contagious, as empty homes reduce the safety and pleasantness of a neighborhood. Addressing individual mortgage borrowers will therefore not suffice. Some banks have already started to work with regional governments, business associations and other stakeholders to revitalize regions as a whole.

SME succession and vacant houses are both difficult issues to address. But by finding solutions, banks may be able to revitalize both their customers and their own businesses.

Greater planning needs for households

Longer life expectancies mean households will need to make their savings last longer. Today, two-thirds of Japanese household financial assets are in the hands of those who are 60 or older. Still many seniors are at a loss as to how to manage their assets, and fear that they may outlive them. When inheritances happen, assets often move from local towns to big cities, with equities and mutual funds cashed in and transformed into bank deposits. Money moves from parents in their nineties to children in their seventies.



Financial institutions are responding to the changes in their customers' needs. They have launched an array of new products and services, including mutual funds fitted to cumulative diversified investments, reverse mortgages, *Tontin* annuities, insurance products with incentives for healthy living, trust services that include support for those with declining cognitive abilities, insurance products with services to diagnose dementia early on, and so on.

Customization, cross-sector, and transparency

But so far, household behavior has not changed significantly. Households are often overwhelmed by too many types of risks and uncertainties, and by planning that spans decades ahead. One-size-fits-all solutions will not work, as older people are diverse in terms of health status, employment, wealth, home ownership and family connections.

Products and services which can address the problems of old age are available, but they are dispersed across a wide range of institutions. These include banks, broker-dealers, asset managers, life and non-life insurance companies, current employers, and the government. This can make solutions difficult for households to assess as each institution only explains and recommends its own products.

Importantly, the biggest potential cash outflow for seniors is not related to financial institutions. Instead, it is the cost and availability of elder care and medical services. It is no wonder that households struggle with these decisions.

Traditionally, the financial industry was segmented into sectors and delivered products according to their own needs and delivery channels. The financial industry did not know much about the life of its customers and addressed small segments of customers' needs and problems.

Customers often struggled to understand what a product or service meant to their lives or businesses, with disclosures contained in thick documents printed in small letters.

Compare this with a customized proposal based on simulations of life scenarios, and combined with financial and non-financial products and services. This could be a great help to households and would go a long way to solving many of the societal problems associated with aging.

To produce such a proposal, information on both customers and available products and services would have to be combined and analyzed. While a difficult task, it is exactly what *FinTech* should be good at. Only someone who is well trusted by the customer could perform this service, but financial institutions are still better trusted than many new players. Financial institutions have the potential to seize this opportunity.

The financial industry in an aging society can turn risks into opportunities by selling solutions, not just products. These solutions should be customized, cross-sectoral and transparent. They should be customized to address the diverse needs of seniors; they should cut across sectors, combining banking, asset management, and insurance services, as well as health and elderly care; and they should be transparent so that customers can visualize what they mean and use them for lifelong financial planning.

JFSA's initiatives

The Financial Services Agency of Japan, the JFSA, has two advisory groups addressing this transformation. One is examining how financial services could be transformed in an aging society. The other is studying how to transform the current entity-based, sector-by-sector regulatory framework into one more oriented towards functions and activities.

In addition, together with the Global Partnership for Financial Inclusion, the JFSA plans to host a high-level symposium on financial inclusion in an aging society on June 7th in Tokyo, as part of our G20 contributions. In an aging society, the degree to which the financial industry provides customized solutions and addresses the broader needs of seniors will affect both the sector's risks and opportunities. In other words, financial stability and financial inclusion will become inseparable in an aging society. We very much look forward to an active dialogue at the June symposium.

65+ may not be a single cohort

Demographic change is a powerful predictor of economic change. Around thirty years ago, Charles Yuji Horioka predicted that the Japanese household saving rate would fall from 14 percent in 1987 to 0 percent in 2007. In fact, the saving rate was around 2 percent in 2007. Many major past banking crises coincided with turning points where demographic bonuses turned into demographic onuses.

But I believe we should not be too deterministic. A person who is 64 today is different from someone who was 64 in the past, or who will be 64 in the future. Economic analysis typically treats people over 65 as a single cohort, but now they play a major role in the economy and deserve a more granular treatment. In Japan, they hold eleven trillion dollars of financial assets, and make up one out of eight workers. The diversity within this group will increase:

- For example, Masako Wakamiya, an 83 year old computer programmer, makes smartphones accessible to the elderly, and has been invited to Apple's annual meeting for software developers; and
- Yuichiro Miura, an 86 year old alpinist, climbed Mount Everest at the age of 80. He plans to climb South America's highest peak, Mount Aconcagua in Argentina, this weekend.

In Japan, the number of people 100 and over will exceed 100,000 in 2021 and 200,000 in 2028. Of course, you would not treat someone who is 65 and someone who is 100 as a single cohort.

The past should not be mechanically extrapolated when designing the future. The financial sector has important roles to play in making structural changes happen and regulators should prepare an environment conducive to these changes. These are not easy tasks, but let me quote the title of another song by the Beatles: *We can work it out*. I hope.

Thank you.